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# ANNUAL REPORT

## FISCAL YEAR 2006

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Profits benefit the  
Vermont Education Fund



[www.vtlottery.com](http://www.vtlottery.com)



Alan R. Yandow, Executive Director

We are pleased to report that last year was a record sales year for the Lottery, with an increase of 13.2% in sales. We also increased the Vermont Education Fund contribution by 12.4%, or \$2.5 million, due to variations in prize payouts.

When the General Assembly established the Lottery in 1977, after a statewide referendum, the Lottery's stated purpose in the enabling legislation was to **"produce the maximum amount of net revenue consonant with the dignity of the state**

**and the general welfare of the people."** Thus, the balance between providing funds for the state's Education Fund and a strong **"Play Responsibly"** message to the public.

Since the sale of the first ticket in February of 1978, the Vermont Lottery has produced over \$1.3 billion in overall sales. From those sales, over \$810 million has been returned to players in the form of prizes, over \$73 million has gone back to the local communities and been paid to local lottery agents in the form of commissions, and over \$364 million went to the state's General or Education Funds (Education Fund since FY 1999).

For your convenience, we now have a new format for the hard copy version of our fiscal year (FY) 2006 Annual Report, one that includes highlights of the past fiscal year, is smaller and easier to read, and less expensive to produce. Please give us a call at 1-800-322-8800 (toll free in VT), or email us at [staff@vtlottery.com](mailto:staff@vtlottery.com), to order one.

The staff and Commissioners of the Vermont Lottery are proud of their past contributions to the State of Vermont, and look forward to increasing the contributions to the state's Education Fund in the next fiscal year, and beyond.

A handwritten signature in black ink that reads "Martha H. O'Connor".

Martha H. O'Connor, Chair

A handwritten signature in black ink that reads "Alan R. Yandow".

Alan R. Yandow, Executive Director



**Vermont Lottery Commission**  
1311 US Route 302 - Berlin, Barre, VT 05641  
(802) 479-5686 • Fax: (802) 479-4294 • [www.vtlottery.com](http://www.vtlottery.com)



1976

In a 1976 referendum regarding the establishment of a state lottery, 66% of those casting ballots voted in favor of the proposal. Based on those results, Public Act No. 82 was enacted by the 1977 General Assembly establishing the Vermont Lottery Commission. The Act also provided for termination of the Lottery on June 30, 1980, unless the 1979 Assembly authorized continuation.

1978

The Vermont Lottery Commission was granted \$250,000 in seed money, which was paid back in full to the state eighteen months later. It took the Lottery seven months from the Commission's inception to produce its first ticket, Green Mountain Game, which went on sale to the public on February 14, 1978. The game was based on a weekly drawing of numbers matched to preprinted numbers on a game ticket. The Lottery's first Instant ticket, Scratch'N Match, went on sale to the public on June 20, 1978.

1979

A steady rise in lottery ticket sales resulted in approval by the 1979 legislature to continue the mission of the Vermont Lottery. Authorization providing for indefinite continuation of the Vermont Lottery was subsequently passed by the 1981 General Assembly.

1998

Since its inception, all profits generated by the Vermont Lottery were dedicated for use by the state's General Fund. In July 1998, the Vermont legislature mandated that all profits from the Lottery go to the state's Education Fund.

2006

The Vermont Lottery continued to be run by a small, efficient staff of professionals consisting of 20 full-time employees and five Commissioners. It is still one of the smallest staffs of any lottery in the United States, yet it generated a record \$104.8 million in ticket revenue during fiscal year 2006.

The Vermont Lottery Commission consists of five members appointed by the governor, with the advice and consent of the state senate. The members are appointed for a three-year term and may not have any pecuniary interest in any contract awarded pursuant to Chapter 14 of Title 31 V.S.A. The Commission is responsible for the public oversight and policies of the Vermont Lottery and no more than three Commission members may belong to the same political party.

**Martha O'Connor**, Chair  
Brattleboro  
Term Expires 06/08

**Tom Scala**, Tri-State Chair  
Brattleboro  
Term Expires 02/09

**Virginia Barry**  
Barre  
Term Expires 02/09

**Arthur Ristau**, Vice Chair  
Barre  
Term Expires 06/07

**Richard Bailey**  
Hyde Park  
Term Expires 06/08

In fiscal year 2006, the Vermont Lottery offered seven different products to customers: Instant Games, Vermont Powerball, Tri-State Megabucks, Tri-State Triple Play, Tri-State Daily Numbers Games, Pick 3/Pick 4, and Tri-State Add-A-Play. Vermont Lottery games are designed to provide fun and entertainment to a broad consumer base by offering an assortment of game options, multiple price points, a range of prize levels, varying odds, and a mixture of themes and play styles.

## Instant Games

Instant Games are sold by all licensed Vermont Lottery agents. Instant Games, also referred to as “scratch off” tickets are paper tickets with latex-covered play areas that instantly reveal if a player has won when scratched. In FY06, Instant tickets accounted for 76.9% of total lottery product sales, the largest revenue source for the Vermont Lottery. Multiple games were on the market simultaneously offering players a variety of price points, play styles, prize levels, top prizes and themes. In FY06, Instant ticket cash prizes ranged from \$1 to \$50,000.



The prize payout, which is the percentage of money that goes back to the player in the form of prizes, ranged from 64% to 75% per game, with an overall payout of 67.5%. This translates to approximately \$66.5 million won in prizes for the Instant product in FY06.

The Vermont Lottery released 56 Instant Games in FY06. Of those games, 17 were \$1 games, 16 were \$2 games, 4 were \$3 games, 11 were \$5 games, 5 were \$10 games and 3 were \$20 games. 20 to 22 Instant Games were on the market simultaneously throughout the fiscal year.

## Vermont Powerball

The Vermont Lottery began offering Powerball to consumers on July 1, 2003. Powerball is a multi-jurisdictional game that offers multi-million dollar jackpots.



In FY06, Powerball was played by selecting five numbers from one to 55. In addition, a sixth Powerball number was selected from one to 42. Players could also multiply their non-jackpot prize by 2, 3, 4 or 5 by selecting the Power Play option. The Power Play option cost an additional \$1 per set of numbers played. The odds of winning the jackpot were 1 in 146.1 million. The jackpot prize was offered in 30 annual installments or in a one-time lump sum cash payment. The cash payment was approximately half the advertised estimated jackpot amount. Winners had 60 calendar days from ticket validation to select a one-time cash payment or annual installments.

Since the game’s first draw on April 22, 1992, Powerball draws have been held at ITC Studios in West Des Moines, Iowa. In FY06, Powerball draws were held on Wednesday and Saturday at 10:59 PM ET. Draws were aired in Vermont on WCAX at 11:00 PM ET.

Powerball jackpots started at an annuitized \$15 million and reached \$365 million in FY06. There were no jackpot winners in Vermont.

## Tri-State Megabucks

Vermont, New Hampshire and Maine formed Tri-State Megabucks in 1985. The Megabucks game has changed several times since 1985



to create the game that players enjoyed in FY06. When the first draw was held on September 14, 1985, players selected six numbers from one to 30, and the odds of winning the jackpot were one in 593,775. A jackpot winner was paid in 20 annual installments. There was one draw per week which was held on Saturday night. The draw was shown on live television.

In January 1986, the Megabucks game was changed to select six numbers from one to 36. The odds of winning the jackpot increased to one in 1.9 million. The draw was still held on Saturday night. In January 1988, the game was modified to select six numbers from one to 40. This increased the jackpot odds to one in 3.8 million. One draw was held weekly on Saturday night. In May, 1990, the number of draws increased to twice a week, Wednesday and Saturday. The draws continued to air on live television.

In June 1996, Megabucks was enhanced to include a feature called, “MegaCash.” This option allowed jackpot winners to take their share of the money available in the jackpot prize pool in a one-time-only, lump sum payment. The cash option was approximately half of the estimated, annuitized jackpot amount.

The game format that was available to players in FY06 was the result of changes made to Megabucks in March 1997.

At that time, the game was modified to select six numbers from one to 42. A seventh number, called the Bonus Number, was also added. The Bonus Number was drawn after the first six numbers were drawn. This seventh number created four more prize levels by adding more ways for players to match their six numbers to the seven numbers drawn. The odds of winning the jackpot increased to one in 5.2 million. The number of jackpot payments changed from 20 to 25 annual installments. MegaCash remained a jackpot payment option. Prior to fiscal year 2002, the jackpot payment option (cash or annual installments) was determined by the player at the time of purchase. This changed in FY02 to allow a jackpot winner 60 days from ticket validation at Vermont Lottery headquarters to elect a one-time cash payment or annual installments.

In FY06 Megabucks draws were held at New Hampshire Lottery headquarters in Concord on Wednesday and Saturday at 7:59 PM. Draws were not aired on television. Following the draws, winning numbers "crawls" were aired on WPTZ/WNNE, FOX 44 and WVNY.

In FY06 jackpot levels started at a guaranteed annuitized \$300,000 with the highest jackpot amount won reaching \$8.35 million.

### Tri-State/Vermont Triple Play

Triple Play sales began on June 26, 2005. This \$2 cash game replaced Tri-State Heads or Tails and is the Lottery's first combined Tri-State and Vermont game. The game was played by selecting five numbers from one to 45. The top prize was a rolling jackpot starting at a guaranteed \$30,000. The odds of winning the top prize were one in 1,221,759. The first draw was held on June 28, 2005. Draws were conducted Tuesday and Friday evenings at 6:50 PM. The draws were not aired on television. Following the draws, winning numbers "crawls" were aired on WPTZ/WNNE, FOX 44 and WVNY.



### Tri-State Daily Numbers

Pick 3 was Vermont's first on-line game. It began on November 10, 1980. Pick 3 has played the same since the game's inception – by selecting a combination of three

numbers from zero to nine. Pick 4 began on September 3, 1985 and has also played the same since its inception – by selecting a combination of four numbers from zero to nine.

The Daily Numbers games became Tri-State games on June 25, 1995. These games were drawn every night from Monday through Saturday at 6:59 PM. On June 7, 1998, a Sunday draw was added. In September 1998, a front pair/back pair feature was added. On June 29, 2003 an additional midday draw was added. In FY06, the draws were not aired on live television. Following the draws, winning numbers "crawls" were aired on WPTZ/WNNE, FOX 44 and WVNY.



## Vermont Lottery Agents

In FY06, there were 770 Lottery sales agents in Vermont. Of those, 744 (total throughout the fiscal year) sold Powerball and Tri-State products. All Lottery agents sold Instant games. Agents received 6% of their total Powerball ticket sales and 5.75% of all other Lottery product sales. In addition, agents received a 1% bonus for selling winning tickets of \$500 and up (agent bonus capped at \$30,000). In FY06, the commission and bonuses paid to agents totaled \$6.15 million.

### Top Five Agents in FY06 Commission Earned

- |             |             |
|-------------|-------------|
| 1. \$51,041 | 4. \$36,717 |
| 2. \$41,615 | 5. \$31,016 |
| 3. \$37,481 |             |

## Tri-State Draws

In 1997, Tri-State draws no longer aired on live television. All draw equipment was moved from WMUR-TV in Manchester, NH (where the draws were held previously) to the New Hampshire Lottery's draw room in Concord, NH. The New Hampshire Lottery draw room was built specifically to conduct draws. When Tri-State draws were held in FY06, the following Tri-State employees were present: draw supervisor, draw monitor and independent auditor. All draws were recorded utilizing the following recording

devices: 8 mm camera, VHS recorder and 24 hour surveillance camera. After each drawing, the 8 mm footage was stored in a secure off-site facility, where it remains for 14 months.

## Phone & Website

Approximately 30 minutes after a draw was conducted, winning numbers were updated on the Lottery's toll free line 1-800-322-8800 (in VT) and on the Lottery's website [www.vtlottery.com](http://www.vtlottery.com).

## Lottery Agents

Lottery agents received the winning numbers shortly after a draw was conducted. In addition, the Lottery terminal could provide eight days of winning numbers.



## Television

Winning number crawls were shown on the following stations in FY06:

<b>WPTZ/WNNE</b>	7:20-7:30 PM 8:20-8:30 PM	Tri-State Daily Numbers & Triple Play Tri-State Megabucks
<b>FOX 44</b>	7:28 PM (7-8:00 Sun) 8:15-8:30 PM	Tri-State Daily Numbers & Triple Play Tri-State Megabucks
<b>WVNY</b>	7:15-7:35 PM 8:00-8:45 PM	Tri-State Daily Numbers & Triple Play Tri-State Megabucks
<b>WCAX</b>	11:00 PM	Powerball Drawing



## Responsible Gaming

During FY06, The Vermont Lottery Commission, in association with the Vermont Council on Problem Gambling, began its tenth year in support of efforts to create awareness of available resources to individuals who have concerns about gambling habits.

## Responsible Play Support

The Lottery's "Responsible Play" campaign included the following efforts in FY06:

### **Partnership with the Vermont Council on Problem**

**Gambling:** At the start of the year, the Vermont Lottery and the Vermont Council on Problem Gambling (VCPG) developed a Responsible Play plan. The Vermont Lottery and the VCPG maintained open lines of communication throughout the year, frequently discussing the Vermont Council's needs and made necessary adjustments.

**Television Campaign:** All television ads produced for the Vermont Lottery included a "please play responsibly" message. In addition, a television ad called, "The Photo," was produced by the Vermont Lottery in collaboration with VCPG, and aired during Problem Gambling Awareness Week.

**Radio Campaign:** All radio ads produced for the Vermont Lottery included a "please play responsibly" message. In addition, the Lottery produced a radio ad in conjunction with "The Photo" television ad. Five percent of the Lottery's radio media was reserved for Responsible Play spots. In addition, many radio stations aired additional spots as public service announcements at no additional cost.

**National Council on Problem Gambling:** The Lottery's Executive Director, Alan Yandow, served on the Board of Directors of the National Council on Problem Gambling.

**Problem Gambling Awareness Week:** During Problem Gambling Awareness Week, the Lottery only aired Responsible Gaming television and radio.

**Vermont Council Toll-Free Funding:** The Lottery provided the financial resources to pay 100% of the expenses for toll-free calls to the VCPG.

**Vermont Council Reimbursement:** The Lottery reimbursed the VCPG for costs associated with registration and attendance of conferences dealing with the issue of problem gambling.

**Responsible Play Message:** All print, broadcast and point of sale produced included the "please play responsibly" message.

**Responsible Gaming on the Website:** Information about the VCPG and links for other resources were included on the Lottery's website: [www.vtlottery.com](http://www.vtlottery.com).

**Logo and Toll Free Number on Lottery Tickets and Play Slips:** The "please play responsibly" logo and the VCPG's toll free number were printed on all Vermont Lottery tickets and play slips.

**18+ and Responsible Message:** Agents prominently displayed "You must be 18 or older to purchase lottery tickets" stickers. These stickers included the "please play responsibly" logo and the Vermont Council's toll free number.

**Advertising Guidelines:** Advertising guidelines developed by the Vermont Lottery were observed in the development of all Lottery marketing materials.

**PLEASE PLAY  
RESPONSIBLY**  
[www.vcpg.org](http://www.vcpg.org)

**Helpline: 1-800-522-4700**

**Advertising Strategy:** The Vermont Lottery's FY06 advertising strategy continued to focus on the fun of playing Lottery games while also stressing the need for responsible gaming. Promoting Lottery games as a fun entertainment choice was achieved by advertising several promotions, including Baseball Bucks, Cabin Fever, Cold Cash and holiday promotions. The advertisements also reinforced that proceeds go to the Vermont Education Fund.

**Media Strategy:** The media goals established for FY06 were designed to provide a consistent level of communications, through public relations and advertising, at minimum frequency levels. The strategy was developed to ensure awareness of Vermont Lottery and Tri-State products. The media campaign consisted of a combination of "base game advertising" – in which the Lottery's base games such as Powerball, Megabucks, Instant Games, were advertised throughout the year and "promotional advertising" – in which media dollars went to support specific short-term promotions. Both proved to be effective.

## Advertising Awareness

In January 2004, the Lottery commissioned the Center for Research & Public Policy (CRPP) to conduct an advertising effectiveness study to measure awareness of the Lottery's advertising messages among the Vermont population. Here are some of the highlights:

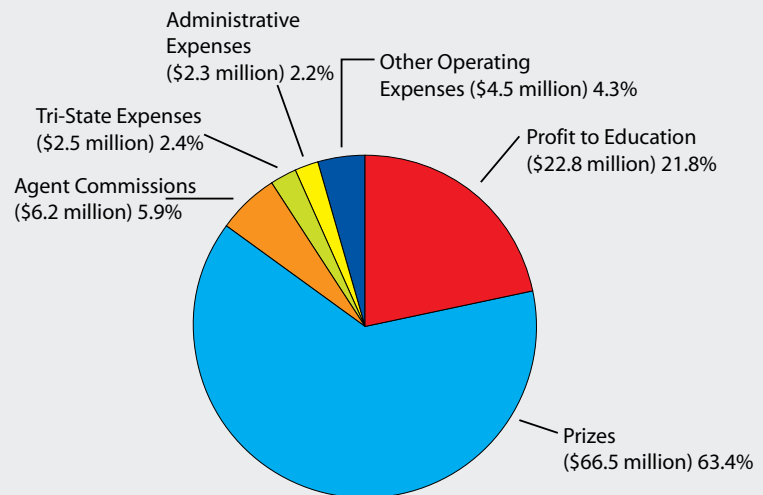
93.7% of players reported seeing, hearing or reading Vermont Lottery advertising over the past 6 months. Among non-players, just less than three quarters, 72.8% suggested the same. Messages with the highest recall include:

- Play Lottery games responsibly
- Lottery games are good, clean, fun
- Lottery games support education in Vermont

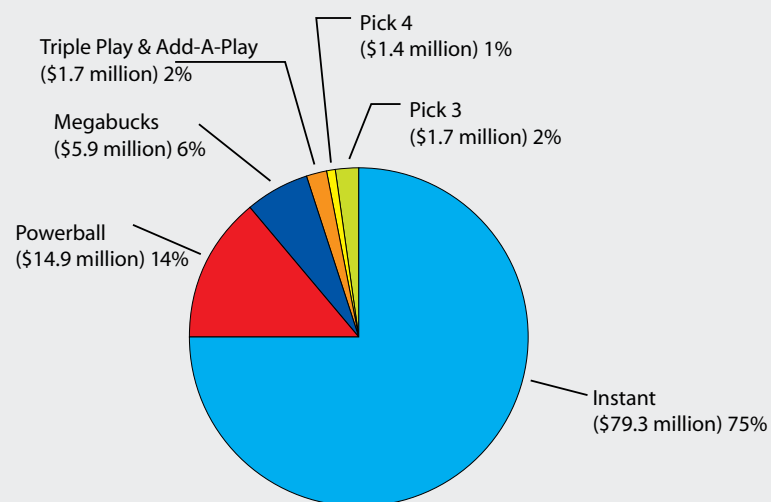
Among players and non-players, characteristics given the greatest importance were:

- Conveying the message that the Lottery's profits go to the Vermont Education Fund
- Conveying the message of playing Vermont Lottery games responsibly

## Where the money went:



## Where the sales were:





Fiscal year (FY) 06 ended with overall revenue of \$104.8 million, up significantly over FY05. The total contribution to the state's Education Fund was \$22.8 million. This was a 12.4% increase over FY05. In addition to the Education Fund contribution, \$66.5 million was returned to players in the form of prizes, and \$6.2 million went to local lottery agents as commissions on sales.

## Sales

The overall results of sales this year showed an increase of 13.2%. Total sales equaled \$104,853,954. Ticket sales were as follows:

	<u>2006</u>	<u>2005</u>
Instant	\$79,323,471	\$71,206,087
Pick 3	1,687,927	1,545,110
Pick 4	1,374,228	1,267,283
Megabucks	5,879,135	5,640,665
Triple Play/Heads or Tails	1,642,766	1,180,938
Add-A-Play	57,249	0
Powerball	<u>14,889,178</u>	<u>11,749,720</u>
Total Sales	<u>\$104,853,954</u>	<u>\$92,589,803</u>

**Instant ticket** sales were \$79,323,471. This was an 11.4% increase over FY05. Instant ticket sales represented 75% of total sales.

**Pick 3 and Pick 4** combined sales were \$3,062,155, an 8.9% increase over FY05. These games represented 3% of total sales.

**Megabucks** sales were \$5,879,135 this year. This was a 4.2% increase over FY05. Megabucks sales represented 6% of total sales.

**Triple Play and Add-A-Play** combined sales were \$1,700,015, a 43.9% increase over Heads or Tails in FY05. Triple Play and Add-A-Play combined represented 2% of total sales.

**Powerball** sales were \$14,889,178, a 26.7% increase over FY05. Powerball sales represented 14% of total sales.

The Lottery received license fees and other receipts of \$24,670. A loss on investments of \$65,877 was recorded as well as a loss on disposal of fixed assets in the amount of \$45.

## Operating Expenses

Administrative costs for the Lottery were \$2,316,495, an increase of \$151,812 over FY05. Administrative costs included salaries, benefits, contracted services, depreciation, equipment, and supplies which were included in the Lottery's annual operating budget appropriation from the Legislature. This budget appropriation came from Lottery revenues.

Other operating expenses included lottery tickets, courier system, Agent network expenses and facilities management fees to our online (Powerball) and Instant ticket gaming system vendor, Scientific Games, International. The total cost of operations for FY06 was \$6,817,965, an increase of \$123,329 over FY05, which includes the administrative costs of \$2,316,495 mentioned above.

## Tri-State Expenses

The Tri-State operating, communications, and facilities management costs totaled \$2,509,426, an increase of \$271,853 over FY05. This was due to the increase in the sales of Tri-State games as these fees are calculated as a percentage of those sales.

## Prizes and Commissions

As these costs were related to sales, prize expense and local lottery agent commissions increased significantly by \$9,281,989 or 14.7% over FY05. Instant Games paid an average of 67.5% of sales back to players. The total prizes paid to players in FY06 were \$66,450,281; and the total commissions paid to Agents were \$6,151,262.

## Contribution to Vermont Education Fund

The total contribution to the Vermont Education Fund of \$22,883,768 was an increase of 12.4% over FY05. The increase is attributable mainly to record high sales. The total contribution to the state's Education Fund in FY05 was \$20,354,442.

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**Mudgett  
Jennett &  
Krogh-Wisner, P.C.**  
Certified Public Accountants #435

The Commissioners  
Vermont Lottery Commission

We have audited the accompanying basic financial statements of the Vermont Lottery Commission, an enterprise fund of the State of Vermont, as of and for the years ended June 30, 2006, and 2005 as listed in the table of contents. These financial statements are the responsibility of the Vermont Lottery Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Vermont State Lottery and are not intended to present the financial position of the State of Vermont and the results of its operations and cash flows of its proprietary fund types and non-expendable trust funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Vermont Lottery Commission as of June 30, 2006, and 2005, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 3, 2006, on our consideration of the Vermont Lottery Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Montpelier, Vermont  
August 3, 2006

*Mudgett, Jennett &  
Krogh-Wisner, P.C.*

This discussion of the Vermont Lottery Commission's financial performance provides an overview of the Commission's financial activities for the fiscal year ended June 30, 2006. Please read it in conjunction with the financial statements.

The Vermont Lottery Commission is an enterprise fund of the State of Vermont. The Commission's operations are classified as business-type activities and reported in a manner similar to commercial entities.

## **Financial Highlights**

- Gross revenues for lottery gaming activities increased by \$12,264,151 or 13.25%.
- Total operating expenses for the year increased by \$10,539,713 or 14.69%. Of this increase, prize expense increased by \$8,554,462, facilities management fees increased by \$304,971, agent commissions increased by \$727,527, Tri-State expenses increased by \$271,853 and all other operating expenses increased by \$680,900.
- Nonoperating expense in FY06 included an unrealized loss on investments. The loss resulted in a decrease of \$72,518 from the nonoperating revenue in FY05.
- Income before operating transfers (net revenue) increased by \$1,666,784.

## **Assets and Net Assets**

The assets of the Commission are primarily cash and investments held for operating purposes. Total assets at June 30, 2006, of \$6,467,413 include capital assets of \$109,925, restricted investments of \$3,028,976 and other operating assets such as cash and cash equivalents, accounts receivable and inventory of \$3,328,512. Net assets retained by the Commission are \$632,434.

Total assets at June 30, 2005, of \$7,595,352 include capital assets of \$140,419, restricted investments of \$3,544,094 and other operating assets such as cash and cash equivalents, accounts receivable and inventory of \$3,910,839. Net assets retained by the Commission at June 30, 2005 were \$1,102,971.

## **Liabilities**

The Commission's liabilities consist of operating liabilities and obligations for payment of prizes to lottery winners. Total liabilities at June 30, 2006, of \$5,834,979 include long-term liabilities for prize obligations of \$2,449,589, cash advances from the State of \$300,000 and other operating liabilities of \$3,085,390.

Total liabilities at June 30, 2005, of \$6,492,381 include long-term liabilities for prize obligations of \$2,704,201, cash advances from the State of \$300,000 and other operating liabilities of \$3,488,180.

## Sales

The following shows ticket sales by game:

	<u>2006</u>	<u>2005</u>
Instant scratch off games	\$79,323,471	\$71,206,087
Online Games:		
Pick 3	1,687,927	1,545,110
Pick 4	1,374,228	1,267,283
Triple Play/Heads or Tails	1,642,766	1,180,938
Add-A-Play	57,249	-
Powerball	14,889,178	11,749,720
Megabucks	<u>5,879,135</u>	<u>5,640,665</u>
<b>Total Sales</b>	<b><u>\$104,853,954</u></b>	<b><u>\$92,589,803</u></b>

## Prizes

In general, prize expense by game will increase or decrease from year to year in proportion to the increase or decrease in sales for a particular game. However, the online game prize expense is also impacted by the luck of the draw. Prize expense for the instant games product category is controllable, to a large degree, by printing a predetermined number and value of winning tickets in the production of each instant game. Prize expense for all other lottery products is not predetermined. While each of these lottery products is designed to yield a certain ratio of prizes to sales over a large number of drawings, actual prize payout is determined by lottery players' luck in matching the particular set of numbers randomly selected in each drawing for each game.

	<u>2006</u>	<u>2005</u>
Prize expense - Instant scratch off games	\$53,547,999	\$47,187,537
Prize expense - Online games	<u>12,902,282</u>	<u>10,708,282</u>
	<b><u>\$66,450,281</u></b>	<b><u>\$57,895,819</u></b>

## Other Potentially Significant Factors

The financial position and operating results for 2006 were improved over 2005 due to increased sales in all games particularly Instant scratch off games and the Powerball game. The Lottery introduced for the first time in 2006 \$20 Instant scratch off games and there were several large Powerball jackpots over \$100 million, two of which were over the \$300 million mark.

The Lottery is a highly visible governmental activity. Its mission is to operate a State Lottery that will produce the maximum amount of net revenue consonant with the dignity of the State and general welfare of the people. There are a number of revenue-enhancing opportunities generally available to the lottery industry. These options, if deemed to be consonant with the general welfare of the people by those in the executive branch and/or legislature, may be considered in future years.

## ASSETS

	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and cash equivalents (Note 2)	\$ 2,386,775	\$ 2,788,797
Accounts receivable (Note 5)	507,269	512,799
Due from the State Education Fund	11,623	11,632
Inventory (Note 6)	422,845	597,611
Total current assets	<u>3,328,512</u>	<u>3,910,839</u>
Restricted and noncurrent assets:		
Investments (Note 4)	3,028,976	3,544,094
Property and equipment, less accumulated depreciation (Note 7)	<u>109,925</u>	<u>140,419</u>
Total restricted and noncurrent assets	<u>3,138,901</u>	<u>3,684,513</u>
Total assets	<u>\$ 6,467,413</u>	<u>\$ 7,595,352</u>

## LIABILITIES AND NET ASSETS

### LIABILITIES:

Current liabilities:		
Accounts payable (Note 8)	\$ 742,956	\$1,372,372
Accrued leave	75,301	71,446
Accrued payroll	64,093	56,325
Current - Due to winners (Note 9)	479,723	470,847
Reserve for future and unclaimed prizes (Note 10)	1,554,375	1,349,503
Deferred revenue (Note 11)	168,942	167,687
Total current liabilities	<u>3,085,390</u>	<u>3,488,180</u>
Liabilities payable from restricted assets:		
Non-current - Due to winners (Note 9)	2,449,589	2,704,201
Cash advances by State Treasurer	300,000	300,000
Total long-term liabilities	<u>2,749,589</u>	<u>3,004,201</u>
Total liabilities	<u>5,834,979</u>	<u>6,492,381</u>

### NET ASSETS:

Invested in capital assets	109,925	140,419
Unrestricted (Note 12)	522,509	962,552
Total net assets	<u>632,434</u>	<u>1,102,971</u>
Total liabilities and net assets	<u>\$ 6,467,413</u>	<u>7,595,352</u>



STATEMENTS OF  
**REVENUES, EXPENSES & CHANGES IN NET ASSETS**  
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
<b>OPERATING REVENUE:</b>		
Ticket sales	\$ 104,853,954	\$ 92,589,803
Agents' license fees and other receipts	24,670	9,806
Total operating revenues	<u>104,878,624</u>	<u>92,599,609</u>
<b>OPERATING EXPENSES:</b>		
Cash prizes	66,450,281	57,895,819
Commissions - agents	6,151,262	5,423,735
Personal services	1,133,298	1,105,961
Lottery tickets	1,274,637	1,178,335
Other operating expenses	619,023	416,997
Advertising	381,788	414,601
Depreciation	37,449	85,114
Supplies	14,937	25,142
Instant ticket dispensers	77,611	53,137
Courier system	205,408	183,059
Facilities management fee - instant	874,008	782,004
Facilities management fee - online	1,886,188	1,673,221
Agent Network Expenses	482,527	255,060
MUSL expenses	171,628	-
Tri-State expenses	2,509,426	2,237,573
Total operating expenses	<u>82,269,471</u>	<u>71,729,758</u>
<b>OPERATING INCOME</b>	<u>22,609,153</u>	<u>20,869,851</u>
<b>NONOPERATING REVENUES (EXPENSES):</b>		
Loss on disposal of fixed assets	(45)	(10,393)
Investment income (loss)	(65,877)	16,989
Total nonoperating revenues (expenses)	<u>(65,922)</u>	<u>6,596</u>
<b>INCOME BEFORE OPERATING TRANSFERS</b>	22,543,231	20,876,447
<b>NET PROFIT TRANSFERRED TO THE STATE OF VERMONT EDUCATION FUND</b>	(22,883,768)	(20,354,442)
<b>CAPITAL CONTRIBUTION TO OTHER FUND</b>	-	(26,868)
<b>TRANSFER TO VERMONT DEPARTMENT OF HEALTH</b>	<u>(130,000)</u>	<u>(90,000)</u>
<b>INCREASE (DECREASE) IN NET ASSETS</b>	(470,537)	405,137
<b>NET ASSETS, beginning of year</b>	<u>1,102,971</u>	<u>697,834</u>
<b>NET ASSETS, end of year</b>	<u>\$ 632,434</u>	<u>\$ 1,102,971</u>

# STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2006 AND 2005 • PAGE 1 OF 2

VERMONT LOTTERY COMMISSION  
ANNUAL REPORT  
FISCAL YEAR 2006

	<u>2006</u>	<u>2005</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Cash received from customers	\$ 104,860,739	\$ 93,123,196
Cash paid for prizes and agents' commissions	(72,467,641)	(63,519,986)
Cash paid for management fees, operations and other	(9,126,597)	(6,922,513)
Cash paid to employees for services	(1,121,675)	(1,094,329)
Other operating revenue	24,670	9,806
Net cash provided by operating activities	<u>22,169,496</u>	<u>21,596,174</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
Operating transfers	(23,013,759)	(20,497,394)
Net cash used in noncapital financing activities	<u>(23,013,759)</u>	<u>(20,497,394)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Acquisition of property and equipment, net	(7,000)	(151,140)
Net cash used in capital and related financing activities	<u>(7,000)</u>	<u>(151,140)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Investment income	203,505	60,683
Proceeds from maturities of investments, net	245,736	247,451
Net cash provided by investing activities	<u>449,241</u>	<u>308,134</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(402,022)	1,255,774
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>2,788,797</u>	<u>1,533,023</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$ <u><u>2,386,775</u></u>	\$ <u><u>2,788,797</u></u>

	<u>2006</u>	<u>2005</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
Operating income	\$ <u>22,609,153</u>	\$ <u>20,869,851</u>
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation	37,449	85,114
(Increase) decrease in the following assets:		
Accounts receivable	5,530	543,216
Inventory	174,766	89,318
Increase (decrease) in the following liabilities:		
Accounts payable	(629,416)	296,616
Accrued salaries and benefits	11,623	11,632
Due to winners	(245,736)	(247,450)
Reserve for future and unclaimed prizes	204,872	(42,300)
Deferred revenue	1,255	(9,823)
Total adjustments	<u>(439,657)</u>	<u>726,323</u>
Net cash provided by operating activities	\$ <u><u>22,169,496</u></u>	\$ <u><u>21,596,174</u></u>

**1. Summary of significant accounting policies:**

The Vermont Lottery Commission (the Lottery) was created by an enactment of the Vermont State Legislature and signed into law by the Governor on April 27, 1977. Title 31, Chapter 14 of the Vermont Statutes is the law under which the Lottery operates. The Lottery is an enterprise fund of the State of Vermont and is managed by a five-member Commission appointed by the Governor for three-year terms. The Commission, by law, has the authority to operate the State lottery, determine the type and forms of lottery games, set the price of lottery tickets, determine the number and size of prizes, select the ticket sales locations and may enter into agreements with another state or states to provide for the operation of the Lottery. Approval of the joint fiscal committee and the Governor shall be required for such contractual agreements with other states.

Fiscal operations of the Lottery commenced in October, 1977. The Lottery's net revenue was transferred to the State of Vermont's General Fund through June 30, 1998. Beginning July 1, 1998, the Lottery's revenue is committed to funding public education, and Lottery net revenue is transferred to the State of Vermont Education Fund on a monthly basis.

The Lottery entered into a compact with the states of Maine and New Hampshire known as the Tri-State Lotto. The compact was enacted to implement the operation of Tri-State Lotto for the purpose of raising additional revenue for each of the party states. Vermont's portion of the Tri-State Lotto operations is accounted for by the Lottery.

In July 2003, the Lottery entered into an agreement with the Multi-State Lottery Association (MUSL) for the inclusion of the Powerball game.

**A. Reporting entity** - The Lottery is included in the State of Vermont's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

**B. Measurement focus and basis of accounting** - The financial statement presentation follows the recommendations of the Governmental Accounting Standards Board (GASB) in its Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Lottery uses the economic resources measurement focus and the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded when the obligation for payment is incurred. The Lottery is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate. Under this basis of accounting and measurement focus, the Lottery applies all GASB pronouncements and Financial Accounting Standards Board (FASB) Statements and interpretations issued on or before November 30, 1989, except those that conflict with a GASB pronouncement. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Lottery has elected not to follow subsequent private sector guidance.

**1. Summary of significant accounting policies (continued):**

**C. Revenue recognition** - Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when the books of the tickets are settled with the retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales of online lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Ticket revenue is recognized weekly. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

**D. Expenses** - Commissions and fees for the instant and online games are recognized weekly. Expenses for administrative and overhead expenses of the operation of the Lottery, except agent and bank commissions, are paid from State appropriations which are derived from Lottery revenues. In addition, Vermont State Statute Title 31, Chapter 14, §658 provides that agency commissions may not exceed 6.25% of gross receipts and bank commissions may not exceed 1% of gross receipts. The statutes also provide that the Lottery must pay out no less than 50% of gross receipts as prizes.

**E. Cash and cash equivalents** - Cash includes demand deposits and short-term investments with a maturity date within three (3) months of the date acquired by the Lottery except for amounts included in the investment account.

**F. Investments** - Investments with readily determinable fair market values are reported at their fair market values on the balance sheet. The Lottery's policy is to retain in net assets the unrealized gains and losses on long-term investments held for the purpose of paying long-term installment prizes due to winners. This policy is consistent with the provision for apportionment of Lottery revenues in Title 31, Chapter 14, §654 (11)(A).

**G. Property and equipment** - Property and equipment are stated at cost, recorded as a capital asset based on the nature of the item and depreciated over the estimated useful life of the asset. Capitalized costs include freight-in, licenses, title application and any other costs required to establish the initial operation of the asset. Improvements and additions to an asset are capitalized. Maintenance and repair costs are not capitalized. Depreciation expense is calculated using the straight-line method over the estimated lives of the assets which are:

Automobiles	3 years
Office furniture and equipment	3-7 years
Improvements	10-15 years

**H. Compensated absences** - Lottery employees are entitled to certain compensated absences based on their length of employment. Generally, compensated absences either vest or accumulate and are accrued when they are earned. Sick leave does not accrue beyond annual use.

**I. Advertising** - Advertising costs are expensed as incurred.

## 1. Summary of significant accounting policies (continued):

**J. Annuities** - The Lottery is the owner of two annuities that were purchased for grand prizes won by two individuals in 1995. The cost of the annuities was charged against the reserve for future prizes at the time of purchase. The annuities were purchased from the following insurance company and have the following expiration dates:

<u>Insurance Company</u>	<u>Annuity Expiration Date</u>
Keyport Life Insurance Company	November 14, 2014
Keyport Life Insurance Company	December 15, 2014

**K. Estimates** - The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**L. Risk management** - The Lottery is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; injuries to individuals; and natural disasters. These are managed by the State of Vermont on behalf of the Lottery.

## 2. Cash and cash equivalents:

**Custodial credit risk - deposits** - Custodial credit risk is the risk that in the event of a bank failure, the Lottery's deposits may not be returned to it. The Lottery does not have a deposit policy for custodial credit risk. As of June 30, 2006, all of the Lottery's bank balance of \$1,403,249 was collateralized. As of June 30, 2005, \$138,517 of the Lottery's bank balance of \$992,914 was uninsured and uncollateralized. Collateralized amounts are held by the pledging bank's trust department in the Lottery's name.

## 3. Cash with State of Vermont Treasurer:

Cash with the State Treasurer represents cash held by the Vermont State Treasurers' Office for the purpose of funding expenditures of the Lottery and transfers to the State of Vermont Education Fund. The expenditures are provided for by an appropriation from the State of Vermont which is derived from Lottery revenues for the operation of the Lottery. The balance in this account is reduced by transfers of net revenue of the Lottery to the State of Vermont Education Fund. There is a surplus in this account at June 30, 2006, and 2005 due to the timing of transfers out of the other cash accounts.



#### 4. Investments/due to winners:

Investments at June 30, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Money Market Funds	\$ 100,000	\$ 100,000
U.S. Treasury Strips	2,269,784	2,732,746
Annuity contracts	<u>659,192</u>	<u>711,348</u>
	<u>\$ 3,028,976</u>	<u>\$ 3,544,094</u>

**Interest rate risk** - The Lottery purchases investments in government securities that will mature in future years to pay multi-year payment prizes won by certain instant ticket winners (see Note 9). These are held by the Trust Department of the Chittenden Bank in Burlington, Vermont, and are reported at market value. The Lottery also owns two annuity contracts purchased for winners which are reported at amortized cost. Because these investments are scheduled to be paid to winners as they mature, the Lottery does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

**Credit, and custodial credit risk** - Investments in the two annuity contracts are both with Keyport Life Insurance Company (see Note 1.J.). These contracts are unrated.

Investments and Due to winners as of June 30, 2006 are \$3,028,976 and \$2,929,312, respectively. Investments and Due to winners as of June 30, 2005 are \$3,544,094 and \$3,175,048, respectively.

#### 5. Accounts receivable:

Accounts receivable at June 30 consisted of the following:

	<u>2006</u>	<u>2005</u>
MUSL	\$ 480,000	\$ 394,055
Tri-State	238	-
Instant Agents	30,108	24,857
Instant Chains	-	66,006
Online Agents	7,171	5,714
Online Chains	<u>-</u>	<u>32,415</u>
Total	517,517	523,047
Less: Allowance for doubtful accounts	<u>(10,248)</u>	<u>(10,248)</u>
Net accounts receivable	<u>\$ 507,269</u>	<u>\$512,799</u>

## 6. Inventory:

The Lottery had inventory consisting of lottery tickets on hand and prizes valued at a cost of \$420,660 and \$2,185 at June 30, 2006 and \$593,506 and \$4,105 at June 30, 2005, respectively.

## 7. Property and equipment:

The following is a summary of changes in property and equipment during the fiscal years.

### 2006

	Balance July 1, 2005	Additions & Adjustments	Transfers	Retirements	Balance June 30, 2006	Accumulated Depreciation	Net Property & Equipment June 30, 2006
Computer equipment	\$ 41,239	\$ -	\$ -	\$ -	\$ 41,239	\$ (38,977)	\$ 2,262
Furniture & fixtures	56,114	-	-	-	56,114	(40,651)	15,463
Other equipment	122,359	-	-	-	122,359	(71,947)	50,412
Leasehold improvements	50,260	7,000	-	(7,625)	49,635	(7,847)	41,788
	<u>\$ 269,972</u>	<u>\$ 7,000</u>	<u>\$ -</u>	<u>\$ (7,625)</u>	<u>\$ 269,347</u>	<u>\$ (159,422)</u>	<u>\$ 109,925</u>

### 2005

	Balance July 1, 2004	Additions & Adjustments	Transfers	Retirements	Balance June 30, 2005	Accumulated Depreciation	Net Property & Equipment June 30, 2005
Computer equipment	\$ 27,888	\$ 22,442	\$ -	\$ (9,091)	\$ 41,239	\$ (37,116)	\$ 4,123
Furniture & fixtures	9,808	50,549	-	(4,243)	56,114	(35,039)	21,075
Automobiles	193,892	-	(148,075)	(45,817)	-	-	-
Other equipment	37,119	97,664	-	(12,424)	122,359	(46,443)	75,916
Leasehold improvements	29,475	42,635	-	(21,850)	50,260	(10,955)	39,305
	<u>\$ 298,182</u>	<u>\$ 213,290</u>	<u>\$ (148,075)</u>	<u>\$ (93,425)</u>	<u>\$ 269,972</u>	<u>\$ (129,553)</u>	<u>\$ 140,419</u>

## 8. Accounts payable:

The Lottery's accounts payable consisted of the following at June 30:

	<u>2006</u>	<u>2005</u>
Tri-State	\$ -	\$ 132,626
MUSL	595,320	417,342
Vendors	147,636	822,404
	<u>\$ 742,956</u>	<u>\$1,372,372</u>

## 9. Due to winners:

Presented below is a summary of requirements to maturity for long-term installment prizes due to winners awarded as of June 30, 2006, and payable through the year 2024:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Current portion:			
Fiscal year -			
2007	<u>\$ 479,723</u>	<u>\$ 53,277</u>	<u>\$ 534,000</u>
Long-term:			
Fiscal year -			
2008	459,839	74,161	534,000
2009	440,322	93,678	534,000
2010	340,120	89,880	430,000
2011	172,747	57,253	230,000
2012	171,550	58,450	230,000
2013-2017	656,096	293,904	950,000
2018-2022	168,350	231,650	400,000
2023-2024	40,565	79,435	120,000
Total long-term portion	<u>2,449,589</u>	<u>978,411</u>	<u>3,428,000</u>
Total requirements to maturity	<u>\$2,929,312</u>	<u>\$1,032,688</u>	<u>\$3,962,000</u>

Due to winners represents annual payments owed to jackpot winners and is fully funded by investments in U.S. Government Treasury Strips and annuities that mature on a schedule coinciding with the installments (see Note 4).

## 10. Prize expense and reserve for future and unclaimed prizes:

By law, the Lottery must pay a minimum of 50% of gross revenue to participants in the form of prizes. Prize expense is calculated on the basis of total sales multiplied by an approved prize payout percentage. The reserve for future and unclaimed prizes is increased by the prize expense as calculated and reduced by the dollar value of prizes actually paid out. Unclaimed prizes from online games can be used for special prizes, to supplement regular prizes or in the case of instant games can be transferred to the State of Vermont Education Fund for State and local funding of public education.

## 10. Prize expense and reserve for future and unclaimed prizes (continued):

For instant games, the Lottery calculated prize expense at varying percentages according to game design ranging from 63% to 75% for the years ended June 30, 2006 and 2005.

In September 1985, the states of Vermont, Maine and New Hampshire instituted Tri-State Megabucks, with a calculated prize expense of 50% of ticket sales. Megabucks ticket sales in Vermont were approximately \$5.9 million for the year ended June 30, 2006 and \$5.7 million for the year ended June 30, 2005.

The Lottery began offering the Pick 3 and Pick 4 daily numbers games in November 1980 and September 1985 respectively with calculated prize expense of 50% of ticket sales. Effective June 1995 the daily numbers games, Pick 3 and Pick 4, became Tri-State games. Pick 3 and Pick 4 sales in Vermont were approximately \$3.1 million of the year ended June 30, 2006 and \$2.8 for the year ended June 30, 2005.

The Tri-State Lotto Commission's net assets for the years ending June 30, 2006 and 2005 were \$12,926,365 and \$23,911,439, respectively. Of these amounts, \$4,095,585 represented designated prize reserves for each year and \$8,830,780 and \$19,815,854 represented unrealized gains on investments held for installment prize obligations for the years ended June 30, 2006 and 2005, respectively. The Tri-State Lotto Commission's annual financial report may be obtained by writing to the Tri-State Lotto Commission, 1311 US Route 302 - Berlin, Barre, Vermont 05641.

Effective July 1, 2003, the Lottery became a member of the Multi-State Lottery Association (MUSL), which operates online games on behalf of participating state lotteries. Each MUSL member sells game tickets through its agents and makes weekly wire transfers to the MUSL in an amount equivalent to the member's share of the estimated grand prize liability. Each MUSL member pays non-jackpot prizes directly to the winners. The MUSL operates the Powerball game, as well as the Power Play feature associated with Powerball. Participating lotteries are required to maintain deposits with MUSL for contingency reserves to protect MUSL from unforeseen prize liabilities. The money in this reserve fund is refundable to MUSL members if the MUSL disbands or if a member leaves the MUSL Board. Vermont Powerball sales were approximately \$14.9 million for the year ended June 30, 2006 and approximately \$11.7 million for the year ended June 30, 2005. On behalf of the Lottery, MUSL held in trust prize reserve accounts for Powerball and Power Play of \$120,000 and \$360,000 respectively for the fiscal year ended June 30, 2006 and \$144,214 and \$201,793 respectively for the fiscal year ended June 30, 2005. The MUSL annual financial report may be obtained by writing to the Multi-State Lottery Association, 1701-48th Street, Suite 210, West Des Moines, Iowa 50266-6723.

In July 2005, the states of Vermont, Maine, and New Hampshire began Triple Play replacing Heads or Tails with an estimated overall payout of 57% of ticket sales. Triple Play is a joint venture between Tri-State and Vermont. It is a two dollar game, one dollar of sales being recognized by Tri-State with an estimated payout of 50%, the other dollar of sales recognized by the Vermont Lottery with an estimated payout of 64%. The total sales in Vermont for Triple Play were approximately \$1.6 million for the year ended June 30, 2006. The sales in Vermont for Heads or Tails were approximately \$1.2 million for the year ended June 30, 2005.

## 11. Deferred revenue:

Deferred revenue consists of subscription receipts for the Megabucks game and Advance tickets sold for the Powerball game. The revenue will be recognized as the drawings are held.

## 12. Net assets:

Net assets invested in capital assets of \$109,925 includes furniture, equipment and leasehold improvements net of depreciation. Unrestricted net assets at June 30, 2006, include net assets reserved for ticket inventory of \$422,845 and for unrealized gains on investments held for the purpose of paying long-term installment prizes due to winners of \$99,664. These reserves are consistent with the provision for apportionment of Lottery revenues in Title 31, Chapter 14, §654(11)(A) & (B).

### 13. Appropriations:

The following are the cash basis appropriations compared to expenses at June 30:

	<u>2006</u>	<u>2005</u>
Appropriation	\$2,338,544	\$2,356,901
Expenditures	<u>2,139,103</u>	<u>2,354,906</u>
Variance	<u>\$ 199,441</u>	<u>\$ 1,995</u>

At June 30, 2006, \$63,721 was encumbered for personal services, equipment and software purchases. At June 30, 2005, \$1,785 was encumbered for personal services.

### 14. Retirement plan:

The Vermont State Retirement System (VSRS), a defined benefit plan, covers substantially all Lottery employees except employees hired in a temporary capacity. Membership in the system is a condition of employment. The membership consists of employees who belong to the original contributory system with a contribution range of 5.1% to 6.28% of payroll (Groups A, C and D), vested members of the non-contributory system (Group E) as well as members of a new contributory system whose current contribution rate is 3.35% (Group F). All eligible employees of the Lottery are Group F members. The total amount of employer contributions was \$78,544. The Lottery's current year payroll for all employees totaled \$812,261 all of which is covered payroll for the plan. Funding and benefit information for this plan is maintained in the aggregate, not by Agency or Commission. Additional information regarding this plan is available upon request from the State of Vermont.

### 15. Deferred compensation:

The State offers its employees a deferred compensation plan created in accordance with section 457 of the Internal Revenue Code. The plan, available to all Lottery employees, permits them to defer a portion of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death or an unforeseeable emergency.

In compliance with Federal mandates, the Vermont State Retirement Board adopted a Plan Trust Declaration for the State of Vermont's Deferred Compensation Plan effective January 1, 1999. The Federal mandate was established to protect the assets of deferred compensation plans by requiring the assets be placed in a trust to be used for the sole purpose of plan participants. After January 1, 1999, the plan assets are no longer considered assets of the State of Vermont.

### 16. Concentrations:

The Lottery utilizes Scientific Games International (SGI), a service organization, to process all its online games and generate accounting reports the Lottery uses to record this activity. The Lottery also utilizes SGI to produce, validate and settle its instant ticket lottery games. Other service providers are available; however, an interruption in service by SGI could have an adverse impact on the Lottery's revenues.

### 17. Commitments:

The State of Vermont entered into an agreement on behalf of the Lottery for office space. The lease commenced September 1, 2004 for ten years. The annual rent is \$129,675 for the first five years and \$142,576 for the remaining five years through August 31, 2014. The annual rent for the years ended June 30, 2006 and June 30, 2005 was \$129,675 and \$122,463, respectively.

The Lottery has a two-year agreement with Scientific Games International to print instant game tickets through January 15, 2008 with an option to renew for two, one-year extensions. The total cost of the contract is not to exceed \$3.5 million.

The Lottery is contracted with Scientific Games International to provide for the operation of an online gaming system through June 30, 2010. The estimated total contract price is approximately \$45 million over the ten-year contract.

**Mudgett  
Jennett &  
Krogh-Wisner, P.C.**  
Certified Public Accountants #435

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS**

The Commissioners  
Vermont Lottery Commission

We have audited the basic financial statements of the Vermont Lottery Commission as of and for the year ended June 30, 2006, and have issued our report thereon dated August 3, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Vermont Lottery Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Commission, management and the State of Vermont and is not intended to be and should not be used by anyone other than those specified parties.

Montpelier, Vermont  
August 3, 2006

*Mudgett, Jennett &  
Krogh-Wisner, P.C.*





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Fran McAvoy

Sylvia Buzzell

Glenn Clifton

Timothy White (FY06)

Gweneth Dean

Wendy Dickinson

Lou Chap

Mark Anderson